DEC 4 PAGE 3

No. 98-585

Supreme Court, U.S.
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In The

Supreme Court of the United States

October Term, 1998

ROBERT D. KRUMME, *et al.*,

Petitioners,

vs.

WESTPOINT STEVENS INC., formerly known as WEST POINT-PEPPERELL, INC., *et al.*,

Respondents.

On Petition for Writ of Certiorari in the United States Court of Appeals for the Second Circuit

PETITIONERS' REPLY BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

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TABLE OF CONTENTS

	Page
Table of Cited Authorities	ii
I. The Second Circuit's Decision Has Wide-Ranging Implications	1
II. The Court Of Appeal's Decision Directly Conflicts With *Dooley v. American Airlines, Inc.*	2
III. The Second Circuit's Decision Conflicts With The Regulatory Scheme For Safeguarding Pension Benefits	3
A. The Second Circuit's Decision Allows an Employer to Circumvent 79-90's Requirements	3
B. The Second Circuit's Decision Conflicts with ERISA	4
C. The Second Circuit's Decision Conflicts with *Curtiss-Wright* and *Frank v. Colt Industries, Inc.*	7
IV. Petitioners Did Not Fail To Pursue An Administrative Remedy	9
V. The Second Circuit's Decision Is Wrong	9
Conclusion	10

TABLE OF CITED AUTHORITIES

Page

Cases:

Curtiss-Wright Corp. v. *Schoonejongen*, 514 U.S. 73 (1995) 1, 7

Dooley v. *American Airlines, Inc.*, 797 F.2d 1447 (7th Cir. 1986) 2, 3

Frank v. *Colt Industries, Inc.*, 910 F.2d 90 (3d Cir. 1990) 7, 8

Inter-Modal Rail Employees Association v. *Atchison, Topeka & Santa Fe Railway Company*, 520 U.S. 510 (1997) 7

Lockheed Corporation v. *Fink*, 517 U.S. 882 (1996) . 8

Varity Corp. v. *Howe*, 516 U.S. 489 (1996) 8

Statutes:

26 U.S.C. § 401(a)(25) 3, 4

26 U.S.C. § 411(a)(7)(A) 6

26 U.S.C. § 411(d)(6) 3

29 U.S.C. § 1002(21)(A) 8

29 U.S.C. § 1002(23) 6

29 U.S.C. § 1054(g) 3, 4, 5

29 U.S.C. § 1054(h) 3

Cited Authorities

Page

Other Authority:

26 C.F.R. § 1.411(d)-3(b) 6

Revenue Ruling 79-90 ..... 2, 3, 4, 5

Petitioners respectfully submit this reply brief in support of their petition for a writ of certiorari. In its Brief in Opposition ("Resp. Br."),[1] WestPoint attempts to downplay the importance and effect of the Court of Appeal's decision by arguing that the decision involves idiosyncratic circumstances and does not conflict with prior rulings of this Court or other Courts of Appeals, or with the regulatory scheme governing pension plans. WestPoint is wrong.

I. THE SECOND CIRCUIT'S DECISION HAS WIDE-RANGING IMPLICATIONS

There is nothing idiosyncratic about the questions presented in the Petition. By allowing an employer to retroactively decrease pension benefits by altering assumptions that are required by law to be specified in a pension plan, without amending the plan and without abiding by the "anti-cutback" provisions of ERISA and the Internal Revenue Code ("IRC"), the Second Circuit has issued a ruling that will adversely affect every pension plan. If the Second Circuit's decision remains the law, any employer can easily circumvent the regulatory framework requiring benefit specificity and certainty by the mere expedient of adopting a provision allowing the employer to change "from time to time" fixed benefit terms and factors without triggering the safeguards that attend plan amendments.

WestPoint also contends that resolution of the questions presented would involve a primarily factual inquiry that this Court should avoid, and that a reversal of the Court of Appeals' decision would affect only Petitioner Krumme. These contentions are also wrong. The questions presented raise issues of law. Indeed, the issue of WestPoint's authority to alter the discount rate was resolved as a matter of law by the District Court upon cross-motions for summary judgment. App. 68a-73a. The Court of Appeals similarly ruled as a matter of law that the Cluett Committee validly adopted a 9.3% discount rate. App. 32a.

WestPoint wrongly cites *Curtiss-Wright Corp.* v. *Schoonejongen*, 514 U.S. 73, 85 (1995) for the proposition that determining "whether a plan sponsor has complied with procedures for changing a plan 'depend[s] on a fact-intensive inquiry' " that is inappropriate for this Court. The Curtiss-Wright pension plan, however, merely designated the "company"

1. Petitioners' Petition for a Writ of Certiorari will be cited herein as "Pet." The Appendix to the Petition for a Writ of Certiorari will be cited as "App." The Respondents' Appendix will be cited as "R. App." Other terms or words used herein are as defined in the original Petition.

as the amending authority. It thus required a factual inquiry under corporate law principles to determine who had authority to act for the "company" and whether the authorized persons had acted to amend the plan. In contrast, the Cluett Plan specifically designates the board of directors as the exclusive authority to amend the Cluett Plan, and it is uncontroverted that they did not act to amend the actuarial factors contained in the Cluett Plan. App. 10a, 52a.

WestPoint's contention that a reversal of the Second Circuit's decision would benefit only Petitioner Krumme because other employees signed releases is inexplicable. If this Court were to ultimately determine that WestPoint's rate change was invalid, the case would necessarily be remanded to the Court of Appeals to address various other issues, including the validity of certain releases, which it did not reach in its decision.[2]

More importantly, the Second Circuit's holding applies not only to petitioners but prospectively to every pension plan. In this regard, WestPoint's remark that the present dispute could not recur, Resp. Pet. 8, is baseless. If the Second Circuit decision remains good law, any employer may now add to its pension plans a provision allowing it to decrease accrued benefits by changing benefit-determinative provisions or factors "from time to time," without amendment and without being restricted by ERISA's and the IRC's anti-cutback provisions.

II. THE COURT OF APPEAL'S DECISION DIRECTLY CONFLICTS WITH *DOOLEY v. AMERICAN AIRLINES, INC.*

WestPoint recognizes — as the Second Circuit did not — that the American Airlines pension plan in *Dooley* did not comply with 79-90. WestPoint attempts to distinguish *Dooley*, however, by contending that the Cluett rate change was specified in a plan document, *i.e.*, the Committee minutes, while the American Airlines rate change was not. The cases are not susceptible to such a distinction. In *Dooley*, the Seventh Circuit ruled that the American Airlines plan did not comply with 79-90

2. In the District Court, the *Allen* plaintiffs contended that certain releases were procured by WestPoint through fraud or mutual mistake. Contrary to WestPoint's contention, Resp. Br. 11, the District Court found that the releases resulted from mutual mistake, but nevertheless declined to rescind them because it imputed to the *Allen* plaintiffs an intent to have a 9.3% discount rate used to calculate their benefits. On appeal, the *Allen* plaintiffs contended that the District Court's imputation of intent was erroneous as a matter of law. The Court of Appeals did not address the release issue, since it found that the discount rate was validly changed in any event.

solely because its grant of authority to change the discount rate "from time to time" without a plan amendment violated the anti-discretion provision of 79-90. The Seventh Circuit might also have found that 79-90 was violated because the American Airlines plan failed to specify the changed rate in the plan document — but it did not. Rather, the Seventh Circuit explicitly based its holding on the plan's failure to comply with the "employer discretion prohibitions" of 79-90 and explicitly refrained from determining whether the bulletins that contained the changed rate were part of the American Airlines plan. 797 F.2d at 1451 n.6, 1452-53. In short, the Seventh Circuit found that the discretionary language of the American Airlines plan failed to comply with 79-90, while the Second Circuit found that identical language in the Cluett Plan did not. The resulting conflict is direct, material and irreconcilable.[3]

III. THE SECOND CIRCUIT'S DECISION CONFLICTS WITH THE REGULATORY SCHEME FOR SAFEGUARDING PENSION BENEFITS

The IRC and ERISA establish a finely reticulated scheme by which a plan sponsor is required to specify actuarial factors for determining benefits in the plan document, where they can be altered only by a plan amendment. Such an amendment must then comply with various safeguards, including ERISA's notice provisions, 29 U.S.C. § 1054(h), and ERISA's and the IRC's prohibition against retroactive reductions of accrued benefits, 29 U.S.C. § 1054(g); 26 U.S.C. § 411(d)(6). WestPoint's attempt to demonstrate that the Second Circuit's decision does not offend this regulatory scheme fails for numerous reasons.

A. The Second Circuit's Decision Allows an Employer to Circumvent 79-90's Requirements

WestPoint contends that the IRC's pension plan provisions are "voluntary," and that an employer's failure to comply with them merely jeopardizes a pension plan's tax benefits. Resp. Br. 12-14. That view is unrealistic in general, inapplicable to the case at bar in particular, and ignores the broader implication of the Second Circuit's decision.

Although an employer could theoretically choose not to comply with the IRC pension plan provisions — as is the case for "top-heavy" plans for senior executives — the consequences of noncompliance by a

3. WestPoint also argues that the Second Circuit cited four other federal decisions in accord with *Dooley*. Resp. Br. 19. None of those cases, however, implicated a provision like 79-90 and 26 U.S.C. § 401(a)(25), that prohibited employer discretion. *See* Pet. 18.

company-wide pension plan like the Cluett Plan would be devastating to both the employer and employees. The employer would lose the deductibility of pension contributions, employees would be faced with taxation of accrued benefits before receiving benefit payments and lump sum payments could not be rolled into tax-deferred accounts. Company-wide pension plans are thus universally designed and operated to comply with the IRC and are represented to employees as providing tax-deferred pension benefits. The present case is an example of a sponsor's efforts to insure IRC compliance. After 79-90 was issued, the Cluett Plan was amended in December 1983, prior to the end of 79-90's grace period, by specifying in the Plan document the 5% discount rate and the applicable mortality table specifically to comply with 79-90. That the 1983 amendment was intended to comply with 79-90 could not be controverted below, as Cluett's filing of the 1983 amendment with the Internal Revenue Service by defendant Roark's own Human Resources Department explicitly stated that the amendment was adopted "to comply with Revenue Ruling 79-90." App. 7a n.4. Thus, WestPoint's contention that it could have chosen not to comply with 79-90 and 26 U.S.C. § 401(a)(25), is irrelevant. The Cluett Plan was meant to comply and the Second Circuit should have construed it accordingly.[4]

Most importantly, if the Second Circuit's decision remains good law, an employer will no longer need to choose between complying with 79-90 and 26 U.S.C. § 401(a)(25), or suffering the substantial tax detriment of noncompliance. Under the Second Circuit's interpretation of 79-90, an employer can now retain the discretion to change actuarial factors "from time to time" without a plan amendment and thereby retroactively reduce accrued benefits, yet still retain a plan's tax qualification. This is precisely the state of law that 79-90 and 26 U.S.C. § 401(a)(25) were designed to change some fifteen years ago.

B. The Second Circuit's Decision Conflicts with ERISA

Contrary to WestPoint's contention, the Second Circuit's decision severely undermines ERISA's anti-cutback provision, 29 U.S.C.

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4. WestPoint argues that its adoption of a discount rate based on a variable standard satisfied 79-90, since 79-90 itself recognized the propriety of such rates. Resp. Br. 14. It was not the PBGC-based rate per se, however, that violated 79-90. Rather, the anti-discretion provision of 79-90 and 26 U.S.C. § 401(a)(25) was violated because the rate was purportedly adopted by discretionary committee action without a plan amendment. The specificity requirement was violated because the PBGC-based rate was never included in the Cluett Plan document.

§ 1054(g). WestPoint argues that the anti-cutback provision — which prohibits a retroactive decrease of accrued benefits by plan amendment — was not triggered here, since the Second Circuit allowed a change in the discount rate without a plan amendment. Resp. Br. 16. WestPoint's argument only proves the point. 79-90 requires an amendment, which in turn activates the anti-cutback prohibitions of ERISA and the IRC. The Second Circuit's decision emasculates ERISA's ability to prevent retroactive decreases of accrued benefits precisely because it allows an employer to change without a plan amendment the actuarial factors specified in a plan document.

WestPoint further contends that it did not violate the anti-cutback provisions in administering the Cluett Plan, since it employed a "split" or "blended" discount rate, *i.e.*, it continued to use the 5% rate to value benefits accrued before the discount rate change and applied the new rate to benefits that accrued subsequently. Resp. Br. 16. By this argument WestPoint seeks to distance itself from the Second Circuit's decision. The Second Circuit explicitly ruled that, because the rate change was effected without a plan amendment, WestPoint did not need to use a blended rate and could apply the new rate retroactively. App. 32a. That WestPoint now contends that it nevertheless did not retroactively reduce accrued Cluett Plan benefits is an implicit acknowledgment that the Second Circuit's decision is untenable.[5]

WestPoint also argues that ERISA's anti-cutback prohibitions were not violated in the present case, since petitioners sued under a non-ERISA-qualified "top-hat" plan. WestPoint is being disingenuous and is simply wrong. Although petitioners' benefits derived from the non-qualified EPI Program, the EPI Program explicitly employed the actuarial factors "contained in" the qualified Cluett Plan. Thus, the Court of Appeal's decision and the questions presented to this Court relate solely to WestPoint's authority to change the factors in the Cluett Plan and directly implicate the ERISA and IRC provisions that govern the tax and ERISA-qualified Cluett Plan. WestPoint's "top-hat" argument was raised and rejected out of hand in both the District Court and the Court of Appeals. App. 32a n.17, 69a.

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5. WestPoint's argument also highlights the complete illogic and error of the Second Circuit's decision. While WestPoint now contends it used a "split" discount rate for the Cluett Plan and did not retroactively apply the new rate, the Second Circuit's decision retroactively applied the new rate to the EPI benefits even though the EPI Amendment states that it must employ the factors "contained in" the Cluett Plan.

WestPoint also argues that the anti-cutback provisions were not violated because there were no "accrued benefits" under the "EPI Amendment" to be improperly reduced. First, the Second Circuit's decision does not rest on any peculiarity of the EPI Program. Rather, it allows the qualified Cluett Plan and every other qualified plan to retroactively reduce accrued benefits. Second, WestPoint's argument is deceptively bottomed on the assumption that the Court will overlook the difference between "accrued benefits" and alternative ways of valuing and paying such benefits. At the time the present dispute arose, the Cluett "EPI Program" already provided accrued benefits to the petitioners, and WestPoint's contrary argument is based on an intellectually dishonest misuse of terms. The normal form of benefit under the "EPI Program" was an annuity-type annual benefit that accrued as an employee's service time and salary increased. App. 5a. By 1989, this normal form of benefit was accrued and vested for each petitioner, most of whom had retired and were already receiving annuity-type benefits. In Mr. Krumme's case, for example, his benefits had fully accrued and vested by April 1996 when he left Cluett, some three years before the EPI Amendment was executed. The "EPI Amendment" to the "EPI Program" merely added an alternative form of payment, *i.e.*, a lump sum, that would be triggered upon a change in control of WestPoint. The Cluett Plan was closely analogous to the EPI Program, in that its benefit accrued over the employee's work life, it was payable in normal form as an annuity-type payment and it also provided a limited lump sum optional form of payment that could be triggered only upon an employee's retirement.

Under ERISA and the IRC, an accrued benefit is defined as the annual form of benefit. *See*, 26 U.S.C. § 411(a)(7)(A); 29 U.S.C. § 1002(23). Thus, when WestPoint argues that there were no "accrued benefits" under the "EPI Amendment" (which merely added an alternative form of payment), WestPoint is being intentionally misleading. The "accrued," annuity-type benefit was provided in the core "EPI Program." Since the lump sum alternative payment method established by the EPI Amendment required that the lump sum be calculated employing actuarial assumptions "contained in" the Cluett Plan, the EPI Participants should have received indirectly by contract the same benefit safeguards provided by both ERISA and the IRC for the Cluett Plan benefits — namely that the actuarial factors could not be retroactively changed to reduce optional lump sum forms of payment based on the annuity-type benefit. *See* 26 C.F.R. § 1.411(d)-3(b); Pet. 14. It is this very misuse of the Cluett Plan that is at issue here.

C. The Second Circuit's Decision Conflicts with *Curtiss-Wright* and *Frank v. Colt Industries, Inc.*

WestPoint's attempt to harmonize the Second Circuit's decision *with Curtiss-Wright Corporation* v. *Schoonejongen*, 514 U.S. 73 (1995) and *Frank* v. *Colt Industries, Inc.*, 910 F.2d 90 (3d Cir. 1990) is unavailing. WestPoint contends that the Cluett Committee minutes were "incorporated" into the Cluett Plan pursuant to a plan provision that makes such minutes "conclusive and binding" and therefore satisfies *Curtiss-Wright's* and ERISA's requirement that a pension plan be contained in a written document. Resp. Br. at 16-17. Such language does not support the claimed incorporation by reference, particularly here, where the Cluett Plan explicitly defined itself as comprised of a particular document and its amendments.[6] The Cluett Plan not only defined itself but explicitly provided for its amendment *exclusively* by the board of directors.[7] WestPoint could not, consistent with *Curtiss-Wright*, and *Colt Industries*, alter the actuarial factors physically specified in the defined plan document through Committee action that admittedly did not comply with the Plan's exclusive amendment procedure.

Petitioners have never argued, as WestPoint contends, Resp. Br. 17, that a pension plan must be contained in a single written document. Indeed, even the Cluett Plan consisted of a document created in 1986 and a number of subsequent amendments. But petitioners do contend, and *Curtiss-Wright*, *Inter-Modal Rail Employees Association* and *Colt Industries* require that where, as here, a plan is explicitly defined and a precise, exclusive amendment procedure is provided, committee minutes

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6. Section 1.26 of the Cluett Plan provides:

> Plan means the Employee Retirement Plan of Cluett Peabody & Co., Inc. as amended and restated as set forth herein, and as it may hereafter be amended from time to time.

Indeed, early in this case, WestPoint stipulated that the Cluett Plan included the 1986 document and its subsequent amendments, but did not include the Committee minutes. The Court of Appeals did not address this stipulation or the Cluett Plan definition.

7. Section 9.1 of the Cluett Plan provides in relevant part:

> The Company acting through the Board of Directors shall have sole authority . . . to amend or terminate in whole or in part, the Plan or the Trust.

Section 11.1 of the Cluett Plan also reserves to the board of directors alone the right to amend the Plan. *See* App. 8 a 7 n.5.

that conflict with terms contained in the defined plan document and that resulted from action that did not comply with the exclusive amendment procedure are not plan documents.

WestPoint's attempt to further distinguish *Colt Industries* because the Colt pension plan was an "integrated" document also fails. Resp. Br. 20-21.[8] The Cluett Plan also explicitly defined itself. As in *Colt*, where the employer has created an identifiable document that sets forth the terms of a benefit plan,

> not every internal document containing a reference to management's interpretation of the plan [like the committee minutes here and in *Colt*] should be regarded as part of the plan itself. Where a plan has complied with ERISA by setting forth a method for accomplishing amendment, of course each putative amendment will be evaluated by reference to that method.

910 F.2d at 98. As in *Colt*, the Committee action in the present case concededly did not amend the Cluett Plan, and the minutes of such ineffective Committee action cannot be deemed part of the plan document.

Finally, WestPoint contends that the distinction between discretionary, administrative action and amendatory action that was recognized in *Curtiss Wright, Varity Corp. v. Howe*, 516 U.S. 489, 498 (1996) and *Lockheed Corporation* v. *Fink*, 517 U.S. 882, 890-91 (1996) is not relevant to the present case since a rate change by the board amendment would also have been "discretionary." Resp. Br. 18. Yet, any plan amendment is "discretionary" in the general sense WestPoint alludes to, since the amending authority always has a choice whether or not to adopt the amendment. In the context of ERISA, however, discretionary, administrative action is distinguished from amendatory action. For example in *Lockheed*, the Lockheed board surely had "discretion" to adopt or not adopt the early retirement amendments in dispute in that case. Yet this Court held that the board's amendatory action was not the type of administrative, discretionary action that created a fiduciary duty under ERISA . *Lockheed*, *supra*, 517 U.S. at 890. WestPoint's reliance on a dictionary definition of the word "discretionary" wholly fails to distinguish this Court's prior decisions, which are based on the language of ERISA. *See* 29 U.S.C. § 1002(21)(A).

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8. WestPoint's contention that petitioners did not cite *Frank* v. *Colt Industries Inc.* in their Second Circuit briefs, Resp. Br. 20, is simply wrong. The case was both cited and included in the table of authorities of the *Allen* Plaintiffs' Brief.

IV. PETITIONERS DID NOT FAIL TO PURSUE AN ADMINISTRATIVE REMEDY

WestPoint contends that certiorari should not be granted because petitioners failed to pursue their administrative remedies under § 9.8 of the Cluett Plan, R. App. 66a. The contention is frivolous.

First, § 9.8 of the Cluett Plan only provides for an administrative appeal where a claim for benefits under the Cluett Plan has been denied. Petitioners have never asserted a claim for benefits under the Cluett Plan. Rather they have asserted a claim for breach of the EPI Program, a separate agreement that employed the actuarial assumptions contained in the Cluett Plan and thus required an interpretation of the Cluett Plan. The EPI Program did not incorporate the administrative appeal process of the Cluett Plan nor did the EPI Program itself provide for an administrative appeal.

Second, the Cluett Plan itself never actually used the 9.3% discount rate approved by the Second Circuit. Indeed, during the period that WestPoint remained in control of the Plan, by its own admission it used a split discount rate to calculate lump sum benefits under the Cluett Plan. R. App. 16. After WestPoint sold Cluett's assets in 1993, the new owner employed the 5% discount rate that petitioners always claimed to be the correct rate. These facts make even more troubling the Second Circuit's decision. Although the petitioners' EPI benefits were to be determined by employing the discount rate contained in the Cluett Plan, the Second Circuit's decision requires the benefit to be calculated with a straight 9.3% discount rate that WestPoint now claims it never used for the Cluett Plan.

V.

THE SECOND CIRCUIT'S DECISION IS WRONG

WestPoint contends that sections 9.6 and 1.3 of the Cluett Plan authorized the Committee to change actuarial factors for determining benefits without a Plan amendment. Resp. Br. at 21-22. The infirmity of this argument as it pertains to § 1.3 has already been fully addressed. Section 9.6 suffers from the further infirmity that it does not control the calculation of pension benefits. The "annual" actuarial valuations and rate adjustments referred to in § 9.6 relate to factors and discount rates used to set *funding* levels. Although § 9.6 on its face and in isolation could be read more expansively, § 1.3 specifically dictates the discount rate to be used in calculating plan *benefits*. Indeed, in the Joint Pre-Trial Order in the Krumme action, WestPoint explicitly stipulated that the discount rate in dispute was the rate contained in § 1.3.

CONCLUSION

For the foregoing reasons, Petitioners respectfully request that a writ of certiorari issue to review the judgment of the Second Circuit.

Respectfully submitted,

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